



Oh Jamaica!

The age-old adage 'when it rains, it pours' seems to be apt in a situation like the one in which Jamaica currently finds itself as the economy confronts numerous and challenging issues. Many investors speculated that the worst may have been over in August 2009, when Standard and Poor's (S&P) downgraded the country's credit rating to 'CCC+' with a negative outlook. In fact, Jamaican Eurobonds rallied on increasingly positive news that the Government of Jamaica was close to 'sealing the deal' with the International Monetary Fund (IMF) for a new Stand-By facility expected to be worth around USD1.2 billion. The Government even received funds from the IMF through its Special Drawing Rights, which helped boost the stock of foreign currency reserves which was in a steady downward trend. All the same, on 2 November 2009, S&P further cut the country's credit rating to 'CCC' and maintained the negative outlook on the rating. According to S&P, when a country is rated as 'CCC', *it is currently vulnerable and dependent on favorable economic conditions to meet its commitments*. This action was triggered by yet another credit event – the resignation of the Governor of the Bank of Jamaica (BOJ), Derick Latibeaudiere.

Over the past few years, Jamaica's economic prospects have worsened amid a barrage of exogenous shocks, including record high energy prices, weather-related disasters as well as the global credit squeeze and subsequent economic recession. Real GDP in Jamaica expanded at an average rate of 1.15% over the last four years but in 2009, this positive growth is expected to reverse and the economy is projected to shrink at a rate of 3.5% as borne out by the contraction within the range of 3.5% to 4.5% during the second quarter of 2009. This represented the sixth consecutive quarter of decline and the sharpest quarterly contraction in the past ten years. The poor performance of the real economy was due to a sharp decline in mining and quarrying, as a result of the closure of two of the three aluminum plants in Jamaica. Remittances, which account for a significant chunk of Jamaica's GDP, averaging just about 18% during the past five years, recently stood at USD153.9mn in July 2009, representing a 13.1% decline compared to July 2008. For the period January–July 2009, remittances stood at USD1, 007.9mn, representing a 15.5% decline compared to the same period last year. This severe reduction in repatriated funds has been a direct consequence of the weakness in the US labor market.

The fall-off in tourism and remittances, coupled with the general pessimism surrounding the Jamaican economy, has considerably undermined the foreign exchange market over the past two years. The Jamaican dollar has lost 33% of its value against the US dollar since the beginning of 2007 but has since stabilized around the JMD89/ USD1 level. At the end of the June quarter, net international reserves (NIR) stood at USD1.66 billion but, at the end of September 2009, reserves rose to USD1.933 billion, on account of the USD303mn allocation of Special Drawing Rights in August from the IMF. The country's NIR had been steadily declining during the first seven (7) months of 2009, but the short-term relief provided by

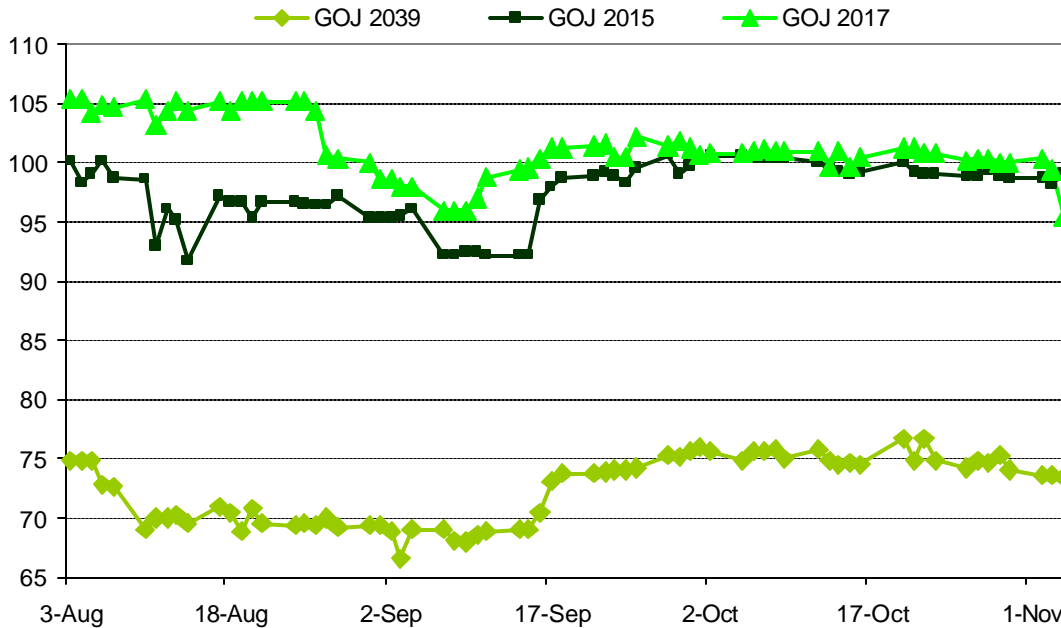
the IMF has helped boost reserves and create relative stability in the foreign exchange markets.

The successive credit rating downgrades in August and November 2009 by S&P highlighted the serious challenges faced by the Jamaican economy. There were some serious concerns about the possibility that the Jamaican government may have had to restructure a portion of their debt. However, in an interview conducted by CMMB with the Jamaican Finance Minister Mr. Audley Shaw, he stated, *“The Government of Jamaica (GOJ) is not and will not be restructuring its external and domestic debt. Liability management exercises are only contemplated when a country has either defaulted or faces such significant challenges that a default is likely. These conditions do not presently pertain to Jamaica. As a result, there is no intention to pursue a restructuring of the external debt. The possible negative consequences of a restructuring would therefore not be an issue for investors. The yields on the GOJ’s Eurobonds have stabilized, indicating some level of investors’ confidence. Jamaica is proud of its impeccable track record of honoring its debt commitment. The reputation loss would likely to be greater than the possible savings to be derived from the execution of a restructuring exercise. Under the Constitution debt is a first charge on the Budget.”*

Investors have been keenly monitoring the progress of the discussions between the Jamaican government and the IMF, as this would provide support to any economic recovery. Many speculated that without substantial support from the IMF and other multilateral institutions, the government may not have been able to meet its short-term financial obligations, hence the reason for the first credit rating downgrade by S&P in August. During the first week of November, another credit event triggered a further downgrade by S&P to the country’s already weak credit ranking – the resignation of the Bank of Jamaica’s Governor Derick Latibeaudiere, who, according to S&P, was the lead negotiator on the possible stand-by facility arrangement from the IMF. Almost immediately following the action by S&P, the IMF issued a press release in which a spokesperson stated that a Fund mission is currently in Kingston and discussions on the arrangement are *“continuing to make progress.”*

Even though the downgrade is just a whisper away from ‘default’ levels, the financial markets remained relatively calm. The Jamaican dollar initially depreciated 0.49% against the US dollar, but subsequently strengthened to JMD88.775/USD1 while on the heels of the rating action, Jamaican Eurobonds marginally declined. The graph below shows the movements in selected GOJ Eurobonds since the first downgrade in August 2009 to current.

GOJ Eurobond Prices



Source: Bloomberg

Despite the relative serenity in the Jamaican markets, we expect that without fiscal restraint by the government, the ability to service debt will become an ever increasingly uphill battle. Interest payments already account for a whopping 60% of total government revenue, giving the government little or no flexibility in terms of fiscal policy. It seems as though harsh measures must be swiftly implemented, including expenditure cuts and even more difficult tax hikes. In the interview with Minister Shaw, he outlined that the government strategy over the short-term is to aggressively reduce expenditure (interest cost) and increase tax revenues, through tax reform, including widening the tax base. The debt management strategy over the medium-term includes the liquidation of high-yielding debt and replacing them with lower-cost securities.

Investors are now waiting with bated breath for the finalization of the IMF USD1.2 billion Stand-By arrangement that may provide the rest pit the Jamaican government so badly needs at this juncture. Nevertheless, some crucial fiscal restraint policies must not be too far off for the Golding administration and it must be prepared to take those politically-suicidal measures to lift some of the fiscal burden. Hopefully, these measures will be sufficient to prevent what now looks like a highly probable debt restructuring exercise.

FINANCIAL & ECONOMIC INDICATORS

As at 5 November, 2009

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	90.71	91.41
Euro	1.49	1.48
Jamaica	89.25	89.22
Guyana	204.70	204.70

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	79.62	79.87
Natural Gas (US\$/mmbtu)	4.30	4.57
Gold (US\$/Troy Ounce)	1,090.30	1,047.00

Eurobond Indices (As at 05-11-09)

Lehman Brothers Global Aggregate Index (Return % YTD)	8.36
JP Morgan EMBI+ (Basis points)	316
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	31.50

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0.13	0.12
Euro Zone	1.00	1.00
Japan	0.10	0.10
Brazil	8.75	8.75
Trinidad	6.25	6.25
Jamaica	12.50	12.50
Barbados	2.50	2.50

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.04	0.05
US 10-Yr Treasury	3.53	3.50
3-month UK Libor	0.61	0.59
Japan 90-day T-Bill	0.28	0.28
Brazil 90-day T-Bill	8.60	8.60
TT 90-day T-Bill	1.40	1.49
Jamaica 90-day T-Bill	16.21	16.39
Barbados 90-day T-Bill	3.48	3.51

Sources: Bloomberg, J.P. Morgan, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

DISCLAIMER

The information contained in this documentation is for your information only. All information contained in this documentation has been obtained from and is based on sources, including but not limited to, newspaper and magazine articles that CMMB believes to be accurate and reliable. However such information, facts, calculations, methodology, assumptions and estimates contained in this documentation have not been verified by us. All opinions and estimates constitute the Author's judgment as of the date of the documentation which are subject to change; however neither its accuracy and completeness nor the opinions based thereon are guaranteed. As such, no warranty, express or implied, as to the accuracy, timeliness or completeness of this documentation is given or made by CMMB in any form whatsoever. Consequently, CMMB assumes no liability for the accompanying information, which is being provided to you solely for general information.